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THE MEXICAN FINANCIAL CRISIS

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

HIS DETERMINATION THAT IT IS NECESSARY FOR THE EXCHANGE STABILIZATION FUND TO PROVIDE LOANS AND CREDITS WITH MATURITIES OF GREATER THAN 6 MONTHS TO THE GOVERNMENT OF MEXICO AND THE BANK OF MEXICO, PURSUANT TO 31 U.S.C. 5302(b)



MARCH 9, 1995.—Message and accompanying papers referred to the Committee on Banking and Financial Services and ordered to be printed

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To the Congress of the United States:

On January 31, 1995, I determined pursuant to 31 U.S.C. 5302(b) that the economic crisis in Mexico posed "unique and emergency circumstances" that justified the use of the Exchange Stabilization Fund (ESF) to provide loans and credits with maturities of greater than 6 months to the Government of Mexico and the Bank of Mexico. Consistent with the requirements of 31 U.S.C. 5302(b), I am hereby notifying the Congress of that determination. The congressional leadership issued a joint statement with me on January 31, 1995, in which we all agreed that such use of the ESF was a necessary and appropriate response to the Mexican financial crisis and in the United States' vital national interest.

On February 21, 1995, the Secretary of the Treasury and the Mexican Secretary of Finance and Public Credit signed four agreements that provide the framework and specific legal arrangements under which up to \$20 billion in support will be made available from the ESF to the Government of Mexico and the Bank of Mexico. Under these agreements, the United States will provide three forms of support to Mexico: short-term swaps through which Mexico borrows dollars for 90 days and that can be rolled over for up to 1 year; medium-term swaps through which Mexico can borrow dollars for up to 5 years; and securities guarantees having maturities of up to 10 years.

Repayment of these loans and guarantees is backed by revenues from the export of crude oil and petroleum products formalized in an agreement signed by the United States, the Government of Mexico, and the Mexican government's oil company. In addition, as added protection in the unlikely event of default, the United States is requiring Mexico to maintain the value of the pesos it deposits with the United States in connection with the medium-term swaps. Therefore, should the rate of exchange of the peso against the U.S. dollar drop during the time the United States holds pesos, Mexico would be required to provide the United States with enough additional pesos to reflect the rate of exchange prevailing at the conclusion of the swap.

I am enclosing a Fact Sheet prepared by the Department of the Treasury that provides greater details concerning the terms of the four agreements. I am also enclosing a summary of the economic policy actions that the Government of Mexico and the Central Bank have agreed to take as a condition of receiving assistance.

The agreements we have signed with Mexico are part of a multilateral effort involving contributions from other countries and multilateral institutions. The Board of the International Monetary Fund has approved up to \$17.8 billion in medium-term assistance for Mexico, subject to Mexico's meeting appropriate economic conditions. Of this amount, \$7.8 billion has already been disbursed, and additional conditional assistance will become available beginning in

July of this year. In addition, the Bank for International Settlements is expected to provide \$10 billion in short-term assistance.

The current Mexican financial crisis is a liquidity crisis that has had a significant destabilizing effect on the exchange rate of the peso, with consequences for the overall exchange rate system. The spill-over effects of inaction in response to this crisis would be significant for other emerging market economies, particularly those in Latin America, as well as for the United States. Using the ESF to respond to this crisis is therefore plainly consistent with the purpose of 31 U.S.C. 5302(b): to give the United States the ability to take action consistent with its obligations in the International Monetary Fund to assure orderly exchange arrangements and a stable system of exchange rates.

The Mexican peso crisis erupted with such suddenness and in such magnitude as to render the usual short-term approaches to a liquidity crisis inadequate to address the problem. To resolve problems arising from Mexico's short-term debt burden, longer term solutions are necessary in order to avoid further pressure on the exchange rate of the peso. These facts present unique and emergency circumstances, and it is therefore both appropriate and necessary to make the ESF available to extend credits and loans to Mexico in excess of 6 months.

WILLIAM J. CLINTON.

THE WHITE HOUSE, *March 9, 1995.*

FACT SHEET ON UNITED STATES SUPPORT FOR MEXICO

I. OVERVIEW

Support

The United States and Mexico have signed agreements implementing the \$20 billion support package put forward by President Clinton to protect United States jobs, exports, immigration interests, and security concerns threatened by Mexico's liquidity crisis.

Conditions

Mexico has announced an aggressive economic program which it intends to follow in order to restore financial stability. United States support is being extended to bolster that effort, by enabling Mexico to meet short-term obligations and restructure its debt.

Safeguards

These agreements set up transparency requirements, notification methods, evaluation procedures, and other mechanisms to safeguard United States interests. Under these accords, proceeds from crude oil and oil product exports will serve as assured sources of repayment of Mexico's obligations to the United States.

II. FORMS AND USE OF UNITED STATES SUPPORT

Three forms of support

These agreements cover three forms of support for Mexico: short-term swaps through which Mexico borrows dollars for 90 days; medium-term swaps that will extend dollars to Mexico for up to five years; guarantees through which the United States will back Mexico's obligations on government securities for up to 10 years. The United States backing will convince investors to lend money to Mexico for longer terms at lower interest rates.

Use of support

Mexico will use the dollars the U.S. provides or the funds raised with U.S. guarantees to retire, refinance, or restructure short-term obligations. This will allow Mexico to shift its borrowing to more stable, long-term sources of finance.

Financial plan

Mexico has developed a financial plan with which the United States concurs that will govern how Mexico uses U.S. support to accomplish its refinancing. Under this plan Mexico over the coming year should refinance \$16 billion of about \$21.5 billion tesobonos which remain outstanding.

Fees and charges

The United States will charge Mexico interest for the medium-term swaps, and fees for the securities guarantees. The fee and interest structure has been set to be appropriate cover for all risks the United States will bear. Moreover, fees and interest rates rise the more support Mexico draws upon, in order to encourage Mexico to turn first to market sources of finance. For the medium-term swaps, interest charges begin with the 91-day U.S. Treasury bill rate to which a risk-premium of 225 to 375 basis points or more is added. The guarantees incorporate a similar fee structure with Mexico paying the difference between the present value of risk-free repayment streams and streams discounted by a risk premium of 225 to 375 basis points or more.

III. ECONOMIC CONDITIONS

Economic targets

U.S. support builds upon and adds to Mexico's commitment to meet the rigorous monetary, fiscal, and structural policy targets upon which it agreed with the IMF. Briefly summarized, these targets include: pursuit of tight monetary policy with negative real money growth, reduced government spending leading to a surplus of 0.5 percent for 1995, further privatization and other structural reforms.

Monetary policy

Moreover, Mexico has put forward an additional economic policy memorandum which underlies these agreements. In it, Mexico affirms the independence of its central bank, and the use of monetary policy to achieve exchange rate stability and resumption of full access to market sources of finance.

Transparency

The Bank of Mexico and the Ministry of Finance have agreed to make publicly available key fiscal and financial data on money and credit aggregates, international reserves, the evolution of public sector debt, and other measures of economic performance. This will provide a clearer picture of how Mexico's economy is doing and whether its economic policy targets specified in these agreements are being met.

Staged support

The United States will make the support available in stages, as needed, subject to our determination that Mexico is adhering to its announced policies.

IV. SAFEGUARDS

Notification requirements

The Mexicans will be required to provide the U.S. Treasury with details about how they plan to use U.S. support any time they seek to draw on U.S. resources. For example, Mexico would have to specify what forms of securities would be offered with a new tranche of U.S. guarantees, as well as how the money raised with

U.S. guarantees would be used to retire existing Mexican obligations.

Veto power

The U.S. Treasury may deny any request for a disbursement if Treasury determines that the use is inappropriate, or if it considers that Mexico has not met the conditions set forth in the agreements.

Acceleration

The United States has the right to accelerate Mexico's outstanding obligations to the U.S. if Mexico has failed to comply with certain key provisions of these agreements.

V. OIL BACKING

Proceeds from oil exports

In the unlikely event of default, all of Mexico's obligations to the United States under the new arrangements will be backed by the proceeds from Mexico's crude oil and oil products exports.

Federal reserve of New York

Upon implementation of these agreements, payments for these exports will pass through an account of Bank of Mexico at the Federal Reserve Bank of New York.

Set off to meet Mexican obligations

If Mexico fails to repay Treasury under these agreements, Mexico's obligations will be set off against funds passing through the account.

SUMMARY OF MEXICAN ECONOMIC POLICY ACTIONS

The Government and the Bank of Mexico have reaffirmed and strengthened Mexico's economic program to contain the following actions: To fulfill all commitments undertaken with the IMF in connection with the stand-by arrangements. To respond to the financial crisis with additional policy steps. To direct monetary policy to the objectives of reducing inflation, strengthening the peso, and encouraging the restoration of spontaneous capital inflows. To that end, the Bank of Mexico:

Points out that under the law it is fully an independent institution;

Reiterates that it will maintain an upper limit for net domestic credit expansion of 10 billion Mexican pesos for all of 1995;

Aims to restrain base money growth backed by credit operations to below the rate of inflation;

Points out that short-term interest rates were raised by 10 percentage points on February 20;

Pledges to maintain tight monetary conditions to guarantee the substantially positive real interest rates that are essential to a successful stabilization effort; and

Seeks the stabilization of financial conditions and return of confidence that will permit interest rates to decline over the course of 1995.

To manage the floating exchange rate system, the Mexican financial authorities:

Declare that the peso has been undervalued in recent trading sessions.

Pledge to maintain a credit and interest rate policy that will assure that the peso appreciates from those recent levels;

Are prepared to use the funds available to Mexico from the IMF and other international authorities for intervention to prevent inappropriate exchange rate fluctuations;

Commit to adjust credit and interest rate policies quickly to regain foreign exchange that is spent in intervention operations; and

Aim to develop futures and forward foreign exchange markets.

To deal with the problems of the banking sector,

Liquidity problems will be tackled without relaxing the credit program established by the Bank of Mexico, and with the support of the funds available under the U.S.-Mexico Framework Agreement.

Solvency problems will be handled in a timely and forceful manner, using the procedures established by law.

Depositors will be protected, and fiscal measures will be adopted to cover the resulting costs.

To attain a public sector surplus of 0.5 percent of GDP in 1995, and take additional fiscal measures, if necessary, to strengthen Mexico's economic program.

To accelerate structural reforms in the transportation, telecommunications, and banking sectors.

To raise \$12–14 billion from privatization and concession operations over the next three years.

To improve the transparency of operations of the Government and the Bank of Mexico, by introducing new publications with timely and accurate data reporting operations and financial statistics and by placing that information on the Internet in the near future.

To make use of the funds provided in the U.S.-Mexico Framework Agreement to support a speedy return to full international capital market access.

THE UTILIZATION OF U.S. FUNDING UNDER THE U.S.-MEXICO FRAMEWORK AGREEMENT

Under the U.S.-Mexico Framework Agreement, the United States will make available up to \$20 billion from the U.S. Treasury's Exchange Stabilization Fund. These funds will help the Mexican Government move aggressively to resolve its current financial crisis.

SIGNIFICANT LEVELS OF SUPPORT

The United States Government has committed \$20 billion dollars to the Mexican support program.

\$10 billion will be made available in stages between now and the end of June 1995 as Mexico meets agreed upon targets. \$3 billion will be made available immediately on the effective date of the agreement.

Another \$10 billion will be made available as needed and in stages beginning in July, based on the same terms and conditions.

PROGRAM ADDRESSES MEXICO'S KEY FINANCIAL PROBLEMS

U.S. funding will enable Mexico to meet its tesobono obligations and successfully refinance and restructure its short-term debt.

U.S. funding will support Mexican efforts to strengthen its banking system, including reducing pressure derived from maturing dollar-denominated CDs and other short-term obligations.

U.S. FUNDING WILL REPOSITION THE MEXICAN ECONOMY

By eliminating Mexico's short-term debt problem and strengthening the Mexican banking system, the U.S. financial package enables Mexico to support stable exchange rates.

This plan lets Mexico gain new access to private capital which will allow Mexico to continue to refinance less expensively.

FUNDING MECHANISMS ENCOURAGE LONGER TERM INVESTMENTS

U.S. support will be available as both short- and medium-term swaps and through a program of loan guarantees.

To date, only short-term swaps have been available to Mexico. As part of the Agreement, the U.S. will now begin to provide medium-term swaps as well.

The Mexican Government will also be able to use U.S. funds to guarantee longer-term bonds. A first issue of U.S. guaranteed bonds is anticipated during the second quarter of 1995.

SUMMARY OF AGREEMENTS

Four basic documents embodying commercial agreements between the United States and Mexico implement the Mexican economic stabilization package:

The Framework Agreement serves as an umbrella accord. It broadly defines the terms and conditions for provision of U.S. resources to support Mexican economic stabilization. Each of the financing agreements is consistent with the provisions of the Framework Agreement. The Framework Agreement references the economic policies Mexico has announced that it will pursue, the conditions on eligibility for financing, how satisfaction of these conditions will be determined, how U.S. resources may be used, and how the U.S. will be repaid.

The Medium-Term Exchange Stabilization Agreement specifies the terms and conditions for medium-term (up to 5 years) swap transactions between the U.S. and Mexico. Under the agreement, for every purchase by Mexico of dollars for pesos, Mexico will deposit a corresponding amount of pesos in a Treasury account at the Banco de Mexico. The agreement also specifies the interest rate the U.S. will charge Mexico for the swaps, which will cover the U.S. risk for the transactions. Above specified threshold levels, additional swap transactions will bear increased rates of interest.

The Guarantee Agreement specifies the terms and conditions for guarantees of debt securities issued by Mexico. Under this agreement, no guarantees may be issued for payments or prin-

cipal and interest due more than 10 years after issuance of the guaranteed debt securities. The fee structure for the guarantees is intended to cover Treasury's risk for the guarantees, and, as in the case of the medium-term swaps, will increase with greater outstanding use to encourage Mexico to seek regular private sources of finance.

The Oil Proceeds Facility Agreement establishes a mechanism to provide an assured source of repayment of U.S. resources. Under the agreement, Petróleos Mexicanos (PEMEX) will instruct in foreign customers to make payments for exports of oil, oil products and derivatives into an account at a U.S. bank. That bank, in turn, will be under irrevocable instructions to transfer funds to a Banco de Mexico account at the Federal Reserve Bank of New York (FRBNY), beginning after the effective date of the agreements. As long as Mexico meets its obligations, these funds will be freely available for use by the Bank of Mexico. If Mexico fails to repay the U.S. under any of the financing agreements, Treasury, through the FRBNY, would be entitled to set off its claims against the Banco de Mexico account.